

Real Estate Counseling Group of America — Fall Meeting Report

The September issue of *The Greenfield Advisor* never went to press, in no small part because I was in Chicago to participate in the semi-annual meeting of RECGA, the Real Estate Counseling Group of America.

RECGA was founded back in the 1970's by a group of appraisal scholars, generally organized by the late Dr. Bill Kinnard (former president of the American Real Estate and Urban Economics Association, among other honors, and one of the most prolific writers in real estate valuation). He wanted a relatively small cross-section of well-published "thinkers" on complex real estate problems, and one RECGA member, recounting the rationale for the group, noted that, "Kinnard wanted a source of readily available co-authors." Over the decades, RECGA's membership has included eight past-presidents of the Appraisal Institute, editors of *The Appraisal Journal* and *The Journal of Real Estate Research*, frequent contributors to all of the leading real estate journals, and active participants in the Appraisal Institute, the National Council of Real Estate Investment Fiduciaries, the Counselors of Real Estate, the Weimer School, the Pension Real Estate Association, the Royal Institution of Chartered Surveyors, the American Real Estate Society, and other august groups.

The Fall meetings were held in Chicago, and the numerous presentations were uniformly excellent. We always regret not recounting all of the presentations, out of fear of leaving out something important. However, a couple of key issues stand out.

The Commercial Real Estate Market

While residential real estate and the stock market may very well be on the up-swing, commercial real estate "numbers" still don't make much sense. In short, current transactions reported from major investment portfolios suggest that the bottom hasn't yet been found. For one, the "cap" rates are still probably too high, perhaps as much as 75 or 100 basis points too high across the board. Values could stay solid if continued softness in cap rates is matched by improvements in cash flow fundamentals, but continued softness in employment (and related consumer spending) does not bode well for most sectors, particularly retail and hotels.

There was significant conversation about the apartment sector — your author, for one, believes that a lot of the "softness" in apartments resulted from a flood of condo-conversions and condo-construction coming back into the new construction market, coupled somewhat with the disruptions in the tax-assisted finance markets (which accounts for about half of all apartment development in America). As this excess supply gets absorbed, the demand for apartments will likely increase due to the shrinkage in home ownership rates. No one seems to really know what the economically "right" percentage is for home ownership proclivity in America. We hit about 69% during the middle of the decade, and most economists agree that this was too high. Is 60% the right number? If so, then that sort of pull-back in home ownership rates would suggest a boom market for apartments. On the other hand, the recession has significantly changed the nature of the "household", accelerating the sandwich family (in which Mom and/or Dad take care of both the aging grandparents as well as the semi-unemployed adult children). If this rebounds, that is, if the semi-unemployed kids move back out once the unemployment numbers get better, then this will add fuel to the apartment demand fire.

CMO Refinancings

Collateralized Mortgage Obligations are due for significant refinancing over the next few years. In 2008/9, much of the financial market disruption came from funding long-term assets (many of which were bad to begin with) with short-term sources. While much of the underlying asset toxicity has been flushed from the system, the problem remains that billions of dollars in these instruments will come due in each of the next few years.

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In the “old days”, when a single lender (bank, insurance company, etc.) made a loan with a balloon, a lack of “pay off” at maturity could be dealt with in one of two ways. First, the lender could simply take possession of the underlying asset, either through foreclosure or deed-in-lieu. Second, the lender could restructure the loan for a new term, either simply by “rolling” the note or requiring some recasting of the terms. Indeed, there used to be a pun among bankers, “A rolling note gathers no loss.”

These rules simply don't apply to CMO's. The instruments themselves are simply not amenable to a market that is not prepared to either refinance the entire CMO “as-is” or to pay it off. What's worse, many of the underlying CMO investors are themselves leveraged with notes that are coming due.

The good news? As we all know, part of the “shock” to the system a year ago was the rapidity with which the house of cards fell apart, and the lack of preparedness of the regulators and markets. Today, our system is shaken but not broken, and at least ready to handle the new problems coming down the pike. Nonetheless, until this works its way out of the system, it will be hard for a full recovery to take hold.

On the other hand, CMOs and related instruments were developed in no small part because they were needed. It is hard to imagine global real estate markets without some sort of structured finance. The sort of direct, “Mom and Pop” lending that predominated decades ago is simply not adequate in the modern world. Thus, a great deal of attention will need to be paid to what sort of new instruments will be needed in the future.

Some News from Greenfield

In addition to the RECGA meetings, I also had the pleasure of participating in the Northwest Environmental Business Council's brownfields conference, held in Tacoma on October 14. The topic this year was “Brownfields Redevelopment: Building Sustainable Communities”, and I moderated the panel on identifying brownfield redevelopment opportunities. Greenfield was pleased to be a co-sponsor of this event, and several staff members were in attendance. This is a very active group, and anyone with interest should visit their web site, www.nebc.org.

On Wednesday, October 28, I'll be speaking to students and faculty at Valdosta State University in Georgia. In the morning, I'll have the opportunity to meet with a couple of the business school classes, and that evening, I'll present a paper on appraisal accuracy.

Then, on Wednesday, November 11, I'll be at the Ritz Carleton New Orleans for the Chinese Drywall Litigation Conference, sponsored by HB Litigation Conferences. For more information on this, visit www.litigationconferences.com.

As always, if you would like for Greenfield to provide a speaker on real estate topics, please contact our Client Services Manager, John Casker, either by phone or via e-mail at jcasker@greenfieldadvisors.com.

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